Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FCC 94-226

In the Matter of)
)
Implementation of Sections of) MM Docket No. 93-215
the Cable Television Consumer)
Protection and Competition Act)
of 1992 -- Rate Regulation)

MEMORANDUM OPINION AND ORDER

Adopted: September 2, 1994 Released: September 29, 1994

By the Commission:

I. Background

1. In the initial *Rate Order*, released in May 1993, we adopted a price cap mechanism to govern rates for regulated cable service after initial rates have been established.[1] Under the price cap, cable operators are permitted to adjust their capped rates to reflect costs attributable to inflation as measured by the Gross National Product - Price Index (GNP-PI), as well as for changes in external costs.[2] We declined, however, to adopt a productivity offset to the GNP-PI because the record did not provide a basis for determining productivity gains in the cable industry.[3]

2. In the initial *Cost-of-Service Notice*, released in July 1993, we sought comment on whether the cable television industry has been or will be experiencing efficiency gains and on several alternatives for establishing a productivity offset.[4] In the *Further Notice* in this

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[1] *In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Report and Order*, MM Docket No. 92-266, 8 FCC Rcd 5631, 5776 (1993) (*"Rate Order"*).

[2] External costs are retransmission consent fees, programming costs, taxes, franchise fees, and costs of complying with franchise requirements. *Id.* at 5783 - 5790.

[3] *Id.* at 5777 n.558.

[4] We specifically sought comment on four possible options: (1) no productivity offset; (2) a consumer productivity dividend of 0.5%; (3) a telecommunications industry adjustment of between 3.0% and 3.3%; and (4) a different productivity offset for cable operators. *In*

proceeding, released in March 1994, we tentatively concluded that cable operators should reasonably expect to achieve productivity gains that are comparable to those realized by other communications firms. We noted that cable television and telephone technologies are similar in many ways and have both benefited from technical advances. We stated, however, that while both industries are likely to continue improving their productivity, in the near term, the productivity gains that cable may reasonably expect to achieve may differ from those of telephone operations due to differences in their networks, operations, services and histories. Accordingly, we tentatively concluded that the record did not support the automatic adoption of the same productivity factor for cable systems as local telephone companies.[5] We proposed, and sought comment on, a two percent productivity offset.[6] In the *Further Notice*, we also tentatively concluded that programming costs should not be subject to any productivity offset. We stated that we did not wish to indirectly restrict the ability of programmers to obtain fair value for their products.[7]

II. Comments

3. In response to the *Further Notice*, cable operators contend that a productivity offset would be inappropriate for the cable industry. They argue that the record in this proceeding does not adequately support a productivity offset of two percent, or of any particular level for that matter. Time Warner, for example, notes that only one party offered a specific offset figure which, Time Warner asserts, apparently is based on its use in state regulation of local exchange carriers ("LECs") and not on any serious inquiry into the economics of the cable industry, and is not supported by any economic analysis.[8] These

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the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, MM Docket No. 93-215, *Notice of Proposed Rulemaking*, FCC 93-353 (released July 16, 1993) ("*Cost-of-Service Notice*"), at para. 85.

[5] *In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Report and Order and Further Notice of Proposed Rulemaking*, FCC 93-39, MM Docket. No. 93-215 (released March 30, 1994) ("*Further Notice*") at para. 319.

[6] *Id.* at para. 320.

[7] *Id.* at para. 322.

[8] Time Warner Comments at 31 (referencing the comments to the *Cost-of-Service Notice* of the New Jersey Board of Regulatory Commissioners at 11). *See also* NCTA Comments at 12; TCI Comments at 50-51; Liberty Media Comments at 23-4. NCTA attached a study prepared by Christensen Associates examining the productivity, as measured by subscribership, of three cable multiple system operators covering six percent of the nation's cable subscribers. The study concludes generally that there is no basis for applying a positive productivity offset to the price cap governing cable systems' rates. NCTA

commenters argue that differences between the telephone and cable industries dictate that a productivity offset for the cable industry should not be based on an offset incorporated in the interstate telephone price cap scheme. These differences, according to commenters, are: (1) the relative easing of telephone rate regulation as compared to the re-regulation of cable systems currently underway;[9] (2) differing fixed equipment costs;[10] and (3) the differing units by which productivity growth is measured in the two industries.[11] NCTA explains that the units of regulatory measurement for interstate telephone calls can be either the number of calls completed or the number of minutes of such calls. These units can expand within the system's capacity even if subscribership remains constant, and can grow rapidly in response to price decreases, it states. Thus, according to NCTA, it may be appropriate to have a productivity offset on the price of a call or a call minute as the incremental cost of each unit falls. NCTA states that, in contrast, the unit of regulatory measurement for regulated basic cable service is the number of basic cable subscribers; intensity of usage is irrelevant. NCTA argues that a price reduction for basic cable service will not induce households that already purchase service to purchase more service. NCTA contends that only in areas of low penetration will subscribership change in response to a price decrease, while in areas of high penetration, price decreases likely will not lead to substantial percentage increases in subscribership. NCTA thus asserts that these differences in the units of regulatory measurement further demonstrate the inappropriateness of deriving a productivity offset from the telephone regulatory regime into the cable service price cap scheme.[12] NCTA also provides a study purporting to demonstrate that there has been no increase in productivity in the cable industry based on analyses of cable operators' costs. *Productivity Growth in the Cable Television Industry*, Christensen Associates. We note that Bell Atlantic has contended that NCTA's study would have shown productivity gains if the study also reflected the annual change in average number of active cable service channels.[13]

4. Cable operators also note that, in adopting a productivity offset for common carriers, the Commission reviewed numerous productivity studies demonstrating the historical productivity growth of telephone companies, including two independent studies as well as its

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Comments at 16.

[9] Comcast Comments at 14.

[10] Time Warner argues that telephone companies achieved much of their recent productivity growth through innovations in computer switching, while cable operators' primary future costs still reside in the actual transmission lines and their eventual replacement by fiber optics. Time Warner Comments at 33.

[11] NCTA Comments at 20-22.

[12] *Id.*

[13] Bell Atlantic Reply Comments at 9. *See infra* para. 7.

own short-term study and a long-term study of the telephone industry covering more than 60 years. These parties contend that, given the absence of any studies or data concerning the cable industry, the Commission has no basis on which to determine or implement a productivity offset for the cable industry.[14] Cable operators further argue generally that a productivity offset will dampen the industry's incentives to invest in innovative video services and development of the National Information Infrastructure.[15] Commenters from the cable industry also object to the productivity offset proposal based on (1) the relative immaturity of the cable industry and its supporting technology;[16] (2) the fact that fiber optics and other necessary technological improvements may actually increase cable operators' costs in the near future;[17] and (3) their belief that the price cap, as measured by the GNP-PI, already captures purported efficiency gains.[18]

5. Commenters from the telephone industry, on the other hand, assert that cable operators' rates should be subject to a productivity offset because the current and near-term introduction of fiber optics and other technologies will greatly increase the efficiency of the cable industry. These efficiencies, the telephone companies argue, should be shared with cable operators' subscribers.[19] GTE and Bell Atlantic contend that the telephone and cable industries should have equivalent, or at least similar, productivity offsets given the industries' impending convergence in both technologies and services offered.[20] These commenters note that an offset has been applied to the rates of telephone companies since they became subject to price cap regulation, and argue that industries rapidly converging to compete in the same video programming distribution marketplace should be subject to similar regulatory rate

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[14] *Id.* at 32-33; Continental Comments at 53; Comcast Comments at 14-15; TCI Comments at 51-52.

[15] Comcast Comments at 16; Continental Comments at 53; Viacom Comments at 19-20; CATA Comments at 8-9; Discovery Comments at 9.

[16] Time Warner Comments at 34.

[17] *Id.* at 33-4.

[18] Viacom Comments at 18.

[19] *See, e.g.,* Bell Atlantic Comments at 6.

[20] GTE Comments at 13-14; Bell Atlantic Comments at 3-6, and attached Declaration of Robert G. Harris, Associate Professor in the Walter A. Haas School of Business, University of California at Berkeley at paras. 7-13. *See also* Fred Williamson & Associates Comments at 5.

constraints.[21]

III. Discussion

6. A productivity offset should be based to the extent possible on observed efficiency gains experienced by the cable industry. An accurate productivity offset can assure that regulated cable service rates reflect a portion of the difference between demonstrated efficiency gains experienced by regulated cable operators, if any, and those gains produced in the economy as a whole, as measured by the Commission's chosen price cap index -- the GNP-PI.[22] As such, a correctly designed offset can significantly benefit consumers while permitting cable operators also to share in efficiency gains. In adopting a productivity offset in other contexts, the Commission has had the benefit of numerous Commission-sponsored and independent economic studies, each providing a record of the historical costs and productivity of the relevant industry.

7. We believe that the current record does not provide an adequate factual basis for the incorporation of a productivity offset into the price cap governing cable service rates. The studies that have been submitted are insufficient to demonstrate observed productivity gains. Bell Atlantic's report is the only study submitted in response to the *Further Notice* purporting to provide an economic analysis in support of a productivity offset factor for cable service. However, the report's conclusion is not based on an analysis of costs or productivity in the cable industry; rather, the report essentially argues that cable operators should be subject to an offset, as required of telephone companies, given the rapid convergence of the two industries. No other studies or data have been submitted in support of a productivity offset. Thus, there is no factual basis in the record that would adequately support a two percent productivity offset. Accordingly, we decline to adopt our proposal to incorporate a productivity offset into the price cap governing cable operators' regulated rates for cable service.

8. Accordingly, IT IS ORDERED, that the proposed productivity offset set forth in the *Further Notice* in this proceeding IS NOT ADOPTED.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton

William F. Caton
Acting Secretary

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[21] *Id.* Mr. Harris' declaration notes several instances of cable systems using their fiber-supported networks to move into the information-transferral business. Declaration of Robert Harris at para. 16.

[22] *Further Notice* at para. 321.